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IN THE

Supreme Court of the United States

OCTOBER TERM, A. D. 1935

No. 743

FRANK O. LOWDEN, JAMES E. GORMAN and JOSEPH B. FLEMING, as Trustees of the Estate of THE CHICAGO, ROCK ISLAND AND PACIFIC RAILWAY COMPANY,

Appellants Below,

vs.

NORTHWESTERN NATIONAL BANK AND TRUST COMPANY OF MINNEAPOLIS, MINNESOTA, formerly THE NORTHWESTERN NATIONAL BANK OF MINNEAPOLIS, MINNESOTA,

Appellee Below.

ON CERTIFICATE FROM THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT.

BRIEF AND ARGUMENT FOR APPELLANTS BELOW.

ALEXANDER E. HORN,
EDWARD S. STRINGER,
DANIEL TAYLOR,
MARCUS L. BELL,
Counsel for Appellants Below.

OTIS F. GLENN,
Of Counsel.

State Law Printing Company, 173 W. Madison St., Chicago--FRAnklin 5501

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ON CERTIFICATE FROM THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT.

BRIEF AND ARGUMENT FOR APPELLANTS BELOW.

I.

Reference to Opinion Below.

Lowden v. Northwestern National Bank and Trust Company of Minneapolis (U. S. D. C. Minnesota), 11 Fed. Supp. 929, filed June 17, 1935. The Circuit Court of Appeals for the Eighth Circuit has filed no opinion.

II.

Statement and Grounds of Jurisdiction.

Jurisdiction of this Court rests on the certificate of the United States Circuit Court of Appeals for the Eighth Circuit, certifying to this Court certain questions concerning which it desired instructions for the proper decision of the cause, pursuant to Section 239 of the Judicial Code as amended by the Act of February 13, 1925 (28 U. S. C. 346).

III.

Statement of Case.

It is impossible to state the facts more succinctly than did the Circuit Court of Appeals in its statement.

"The Chicago, Rock Island and Pacific Railway Company is a railroad corporation organized under the laws of Illinois and Iowa, with its principal place of business in Chicago. On June 7, 1933, at 9:55 o'clock A. M., the railroad, desiring to effect a plan of reorganization pursuant to Section 77 of the Bankruptcy Act as amended (11 U. S. C. § 205), filed with the United States District Court for the Northern District of Illinois, Eastern Division, its petition for reorganization under that section. The petition alleged that the railroad was unable to meet its debts as they matured. Upon the filing of the petition, a judge of the court, wherein it was filed, approved it as being properly filed under said Section 77.

"At the time of the filing of the petition (9:55 A. M., June 7, 1933), the railroad had to its credit in a checking account with the Northwestern National Bank and Trust Company of Minneapolis, a national bank, the sum of $36,908.72. At the close of business on that day, the amount to the credit of the railroad in said account was

$45,362.94. The bank on June 7, 1933, owned $100,000.00 par value of First and Refunding Gold Bonds of the railroad. These bonds were not then due and would not by their terms become due until April 1, 1934, and there had been no default upon the bonds in the payment of either principal or interest.

"On June 19, 1933, seven days after it received a copy of the order of the United States District Court for the District of Illinois approving the petition for reorganization filed by the railroad, the bank set off the $45,362.94 which was to the railroad's credit with it at the close of banking hours on the day the petition was filed, against the $100,000.00 of bonds of the railroad owned by the bank by charging the railroad's account with that amount and crediting the same upon the bonds."

In so doing, the bank relied upon Section 68(a) of the Bankruptcy Act (11 U. S. C. § 108) and upon subdivision or paragraph (n) of Section 77 of the Bankruptcy Act (11 U. S. C. § 205). The full text of these provisions will be indicated later.

"The railroad protested the set-off and denied the right of the bank to make it. On June 23, 1933, the bank restored to the account of the railroad the sum of $5,611.32, making the net sum deducted from the account for the purposes of set-off $39,751.62. This restoration was made by the bank because on June 10, 1933, three days after the filing of the petition for reorganization, the balance in the account of the railroad with the bank had been drawn down to $39,751.62 which was the lowest amount standing to the credit of the railroad on the books of the bank between the time of the filing of the petition for reorganization and the time the bank made the set-off. The set-off was made voluntarily by the bank and was not ordered, authorized, approved, or consented to by the court in which the petition for reorganization was filed.

"After trustees were appointed for the railroad pursuant to Section 77, they brought suit in the United States District Court for the District of Minnesota to recover the amount of set-off. That court held that Section 68(a), *supra,* was applicable to proceedings under Section 77, and that the bank was therefore entitled to the set-off; but fixed the amount which the bank was entitled to set off at $36,908.72, being the amount on deposit at 9:55 A. M., June 7, 1933, when the petition for reorganization was filed." (R. 1-3.)

The opinion of the trial court (the United States District Court for the District of Minnesota) is not in this record (11 Fed. Supp. 929). It held in favor of the bank (appellee below). From its decree, the trustees (appellants below) appealed to the Circuit Court of Appeals for the Eighth Circuit, and after argument and submission that court certified the following questions to this court:

IV.

Questions Certified.

Question 1. Does the right of set-off recognized by Section 68(a) of the Bankruptcy Act apply to reorganization proceedings under Section 77 of that Act?

Question 2. If the first question be answered in the affirmative, can a bank which owns the unmatured bonds of a railroad corporation set off a deposit account of the railroad with the bank against the bonds, upon the filing by the railroad of a petition for reorganization under Section 77 of the Bankruptcy Act, alleging that the railroad is unable to meet its debts as they mature?

Question 3. If the first and second questions be answered in the affirmative, may the United States District Court, for the District of Minnesota, in the suit by

the trustees of the railroad's estate to recover the amount deducted from the account of the railroad by the bank under the claimed right of set-off, recognize and establish as a proper set-off by the bank one which was not made until after the filing of the petition for reorganization and which has never been ordered, authorized, approved, or consented to by the court in which that petition was filed and approved?

V.

SUMMARY OF ARGUMENT.

A.

Section 68 is inconsistent with Section 77 and hence is inapplicable to a proceeding under it.

Question 1. Section 68 is part of the old Bankruptcy Act which contemplated a complete liquidation. Section 77 contemplates the converse,—a readjustment of the capital structure of a railway company which must be kept in operation pending reorganization. To permit set-off in a proceeding under Section 77 might well and probably would prevent the attainment of the very purpose of the section. If set-off were permitted a railway company entering into a reorganization proceeding might find itself seriously embarrassed for available cash; to permit set-off is to countenance during reorganization the enforcement of debts by certain creditors to the possible obstruction and hindrance of a reorganization plan. To permit property to be withdrawn from the plan by the act of an outside party could well prevent the accomplishment of any reorganization.

The effect of Section 77 is to vest in the bankruptcy court exclusive jurisdiction of the property of the debtor wherever located; claims against that property can be

dealt with only by the method and under the procedure prescribed by Section 77. This involves a reorganization plan which may alter or modify the rights of creditors, secured and unsecured; the determination by the Interstate Commerce Commission and by the bankruptcy court of what treatment shall be given to each class of creditors. No other court can pass upon these questions.

The sole purpose of Section 77(n) is that the approval of the petition should operate as a writ of sequestration and injunction against creditors. Section 68 is therefore inconsistent with 77 (c, d, e, f and g) in that it would permit unequal treatment of the members of the various classes of creditors, and is inconsistent with 77(j) in that it would permit the enforcement of a claim not recognized by the reorganization plan. It is also inconsistent with 77(c) providing for the operation of the properties during reorganization. If the bank has superior equities because of its claimed right of set-off, these equities may be dealt with only under the plan.

B.

Since the railway's bonds were not due or in default and the railway was not insolvent (but was, as alleged in its reorganization petition, merely "unable to meet its debts as they mature") the unmatured bonds cannot be set off against the bank balance.

Question 2. The general rule is that an unmatured debt cannot be used as a set-off except in the event of insolvency. The railway was not insolvent, hence the set-off cannot be permitted. The rule that an unmatured debt can be set off in a bankruptcy proper is applicable only because an ordinary bankrupt must be insolvent. If Section 68 may ever apply to a proceeding under Sec-

tion 77 it can only be where the railway is in fact insolvent. It is wholly inapplicable where the railway is merely unable to meet its debts as they mature. To hold otherwise would be to accelerate every debt and make a reorganization impossible.

C.

Since the United States District Court for the Northern District of Illinois (the court administering the reorganization proceeding) had never ordered, authorized, approved or consented to the attempted set-off, the trial court below (the District Court for the District of Minnesota) was without authority to allow or recognize it.

Question 3. The only court which could permit or authorize the right of set-off was the United States District Court for the Northern District of Illinois, the court of administration. A set-off cannot be permitted or recognized by any other court in the absence of the approval or consent of the court of administration.

VI.

ARGUMENT.

A.

Question 1. Does the right of set-off recognized by Section 68(a) of the Bankruptcy Act apply to reorganization proceedings under Section 77 of that Act?

Section 68 of the Bankruptcy Act (11 U. S. C. 108) reads as follows:

> "(*a*) In all cases of mutual debts or mutual credits between the estate of a bankrupt and a creditor the account shall be stated and one debt shall be set off against the other, and the balance only shall be allowed or paid.
>
> "(*b*) A set-off or counterclaim shall not be allowed in favor of any debtor of the bankrupt which (1) is not provable against the estate; or (2) was purchased by or transferred to him after the filing of the petition, or within four months before such filing, with a view to such use and with knowledge or notice that such bankrupt was insolvent, or had committed an act of bankruptcy."

Paragraph (n) of Section 77 of the Bankruptcy Act (Act of Congress of March 3, 1933), reads as follows:

> "In proceedings under this section and *consistent with the provisions thereof,* the jurisdiction and powers of the court, the duties of the debtor and the rights and liabilities of creditors, and of all persons with respect to the debtor and his property, shall be the same as if a voluntary petition for adjudication had been filed and a decree of adjudication had been entered on the day when the debtor's petition was filed."

Note: Italics supplied throughout.

If, therefore, Section 68 is inconsistent with the other provisions of Section 77, it is not applicable to this case and no set-off can be permitted.

To determine whether such inconsistency exists, it is necessary not only to examine the text of Section 77 itself, but heed must likewise be given to the conditions existing at the time of its passage and the object and purpose of Congress in passing it.

At that time, as a result of the depression and the consequent loss of revenue, the railroads of the country generally were unable to meet their fixed charges and in practically all instances were operating at a loss. In many instances, they were unable to pay their current debts. Since they were public service corporations, forced liquidation was not to be thought of, and bankruptcy in the ordinary sense was, in any event, forbidden by existing law.

There was only one remedy, an equity receivership. This court in *Duparquet, Huot & Moneuse Company* v. *Evans,* — U. S. —, 56 Supreme Court, 412, filed February 3, 1936, pointed out many of the "abuses" and "defects" in an equity receivership, and what this court said in that case as to the reasons for the enactment of Section 77B is equally applicable to the railroad situation and to Section 77.

Congress sought three things by this legislation:

(1) That the railway's properties should not be liquidated, but that the capital structure should be readjusted and the properties eventually returned to their owners.

(2) That all creditors be stayed in the enforcement of their debts pending the reorganization.

(3) That during the period of reorganization the railway's properties should be continuously operated (subdivision (c)).

As we shall point out, permitting a set-off might prevent either in whole or in part the attainment of all three objectives.

As to the terms of Section 77 itself, no better statement of its substance can be made than by quoting the language of this court in *Continental Illinois National Bank* v. *C., R. I. & P. Ry. Co.*, 294 U. S. 648, involving the reorganization proceedings of this same railroad:

> "By the Act of March 3, 1933, c. 204, 47 Stat. 1467, original jurisdiction, in addition to that theretofore exercised in voluntary and involuntary proceedings to adjudge persons bankrupt, was conferred upon courts of bankruptcy 'in proceedings for the relief of debtors,' as provided in Sections 74, 75 and 77 of the act. We are here concerned only with Section 77. That section contains provisions for the reorganization of railroads engaged in interstate commerce. It permits any railroad corporation which is insolvent or unable to meet its debts as they mature to effect a plan of reorganization.
>
> "It provides for the filing of a petition by the railroad corporation in a court designated by the act. If the petition be approved, the court, during the pendency of the proceedings, is given exclusive jurisdiction of the debtor and its property wherever located. The act requires that the railroad corporation shall be referred to in the proceedings as a 'debtor,' and permits any corporation, the majority of the capital stock of which is owned, or substantially all of whose properties are operated, by the debtor under lease or operating agreement, also to file a petition in the same proceeding stating that it is insolvent or unable to meet its debts as they mature and that it desires to effect a plan of reorganization in connection with the plan of the original debtor.
>
> "Other provisions of the section direct that a plan of reorganization shall include a proposal to modify or alter the rights of creditors generally or of any class of them, secured or unsecured, either

through the issuance of new securities or otherwise; that it shall provide adequate means for its execution; that the term 'creditor' includes 'all holders of claims, interests, or securities of whatever character against the debtor or its property'; and that, if the plan is not proposed or accepted or confirmed within a reasonable time to be fixed by the judge, he may dismiss the proceeding.

"Before acceptance of any plan, the Interstate Commerce Commission is directed to hold a public hearing, following which it shall render a report recommending a plan which 'will, in its opinion, be equitable, will not discriminate unfairly in favor of any class of creditors or stockholders, will be financially advisable * * * and will be compatible with the public interest.' The commission is required to state fully the reasons for its conclusions. The plan is then to be submitted to the creditors and stockholders of the debtor for acceptance or rejection. No plan may be finally approved by the commission until it has been accepted in writing by or on behalf of creditors holding two-thirds in amount of the claims of each class affected by the plan, and by or on behalf of stockholders holding two-thirds of the stock of each class.

"Upon approval by the commission, the judge, after hearing, shall confirm the plan if satisfied, among other things, that the plan affords adequate protection for the realization by creditors of the value of their securities, liens and claims in one of the ways pointed out by the section. Upon confirmation of the plan, it is to be binding not only upon corporation and all stockholders and creditors generally, but upon all secured creditors of each class of which two-thirds in amount shall have accepted the plan."

Subdivision (h) of the Act specifically provides:

"The confirmation of the plan shall discharge the debtor from its debts except as provided in the plan."

Subdivision (n) has already been quoted.

For the full text of Section 77 as originally passed, see Appendix, pages 39 to 56, inclusive.[1]

There is a wide gulf between the purposes of a proceeding under the old act and one under Section 77.

The result sought to be accomplished by the old act was to strip the debtor of his property and divide it, pro rata, among his creditors. The result sought by Section 77 is the direct antithesis. It does not contemplate depriving the debtor of his property, but permits him to retain it and reorganize his debts and capital structure. The old bankruptcy proceeding resulted in commercial death; a reorganization under Section 77 results in commercial life.

This court expressly so held in the *Continental Bank* case, saying:

> "But a proceeding under Section 77 is not an ordinary proceeding in bankruptcy. It is a special proceeding which seeks only to bring about a reorganization if a satisfactory plan to that end can be devised."

Although Section 77 clearly contemplates (1) that the debtor shall retain its property, both during and after the reorganization, and (2) that its debts, secured and unsecured, shall be readjusted, the bank contends and the trial court held that under the theory of a set-off under Section 68 the bank might take the railway's property from it and from the court, and with that property pay the debts owed by the debtor in full without any readjustment. A more glaring example of forced liqui-

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[1] Section 77 as originally enacted was amended by the Act of Congress of August 27, 1935, but in particulars not important here. Subdivision (n) of the original section has become subdivision (l) of the amended Section 77. However, this case is to be governed by the original section, since subdivision (s) of the amended section reads:

> "* * * the enactment of this amendatory section shall not invalidate any action taken before its effective date, pursuant to this section as it existed prior to this amendatory section."

dation which Congress sought to avoid and thought that it had avoided can hardly be imagined. To construe Section 77 so as to permit this would be to hold that it wholly fails to accomplish what was intended, and that the entire working capital of a railroad may be dissipated upon the filing of a reorganization petition. That this is not a mere fanciful danger is apparent when we bear in mind the third purpose of the Act already referred to, *i. e.,* that there shall be continued operation of the railway's properties during reorganization.

This is illustrated by the fact that at the date of the petition the railway company had deposits in perhaps fifty banks, scattered throughout the fourteen states in which its system operates. The figures are not in the record, but the court must recognize that in the daily transactions of collecting cash for freight charges, depositing this cash in the local banks for remittance to central banks, a very large sum of money is involved. If all these banks had been bondholders or security holders of the railway company, and all had attempted to set off the deposits against their bonds, the railway company in the hands of the court would have found itself stripped of cash, unable to meet pay rolls, unable to purchase fuel,—unable to operate. In fact, this very situation prevailed in the case of a smaller company, the St. Louis Southwestern, which filed a petition for reorganization on December 12, 1935, in the Eastern District of Missouri. At the same time that the reorganization petition was filed, a separate petition accompanied it, representing that certain moneys of the railroad were on deposit with a St. Louis bank, which also held the notes of the railway company; that, although the right of set-off had been expressly waived by the bank an attempt to set off the deposits against the notes would embarrass the railway company in the operation of the property, and thereupon the court enjoined the bank

from applying the deposits against its notes (see Petition and Order No. 2, St. L. S. W. bankruptcy proceedings).

Such a result is clearly denounced by the reasoning of this court in the *Continental Bank* case, where this court upheld the right of the district court to enjoin the foreclosure of collateral during the pendency of the reorganization, pointing out that unless such foreclosures were restrained, a reorganization was not possible.

The reason for including the right of set-off in the scheme of bankruptcy under the general bankruptcy law and excluding it from a reorganization proceeding under Section 77 is obvious.

A right of set-off was fairly workable in a scheme which contemplated stripping the debtor of his property and dividing it among creditors, because the only question in such a proceeding was among whom and in what proportions were the assets to be divided. However, even in a bankruptcy proper it was a discordant note, because, while equal division among creditors was the principle upon which the bankruptcy law rested (*Hitchcock* v. *Rollo,* Fed. Cas. 6535, cited with approval in *Cumberland Glass Company* v. *DeWitt,* 237 U. S. 447), yet Section 68, allowing a set-off, in fact, created a preference, although one which this court concluded had to be tolerated when within the literal terms of the section.

New York County National Bank v. *Massey,* 192 U. S. 138.

Studley v. *Boylston National Bank,* 229 U. S. 523.

But to apply Section 68 to a reorganization under Section 77 in which the properties are not to be distributed, but are to be retained and eventually returned to the debtor well could, and, as we have demonstrated, very likely would, entirely prevent the accomplishment of the purpose for which the Act was passed.

Upon the approval of the petition the holder of securities is immediately brought within the operation of the reorganization proceeding. In order to make a start upon the plan two things must be determined: *first,* the nature and amount of claims and securities outstanding, and *second,* the nature and amount of the assets of the trust estate. If either of these elements may be changed during the effort to work out a plan of reorganization, the consummation of any plan will necessarily be impeded, or even prevented. To hold that any security holder may interfere with this process by appropriating all or any part of the assets of the trust estate to the payment of his claim, independently of the plan of reorganization, and set up for himself a special status quite different from the provisions provided by the plan, is unthinkable. A maneuver of that sort would be inconsistent with both the letter and purpose of Section 77.

The rights of creditors become static and unchangeable upon approval of the petition by the court. Thereafter they may be altered only by the plan of reorganization. All suits are stayed, and no mortgages, liens, or claims, prior or preferred, can be realized upon, except at the end of the proceeding, and then only according to the provisions of the plan. Why should the remedial right of set-off be made an exception to this general scheme?

The first and immediate effect of the court's approval of the petition filed under Section 77 is to vest in the court "*exclusive* jurisdiction of the debtor and its property *wherever located.*" This, of course, includes all bank deposits such as the bank's debt in this case. The bank had no right to seize any part of the property of the railway company; all of that property was under the exclusive jurisdiction of the bankruptcy court, and the

court is now, through its trustees, asking the bank to surrender that portion which the bank has seized.

From the moment of the approval of the petition, the rights of the bank as a claimant or a creditor could be dealt with only through the reorganization plan when finally passed upon by the Interstate Commerce Commission representing the public, and by the bankruptcy court. Certainly it was never intended by Section 77 to leave a creditor free, as the bank claims it is free in this case, to apply to his unmatured bonds a debt due the railway company; arbitrarily to take into his own hands the matter of payment of those bonds, without waiting for the commission or the court to determine what is fair and equitable treatment for the bondholders as a class. If this set-off be permitted and the action of the bank be upheld, then the bank has paid off in full, thirty-six, out of its one hundred, First and Refunding Bonds, and may file a claim in the bankruptcy court upon the remaining sixty-four bonds; or may, without notice to anyone, sell the remaining sixty-four bonds on the open market, as it bought them,—and sit back satisfied. Other bondholders, not so fortunate as to have held bank deposits of the railway company, will have to accept for their bonds such securities as may be allotted to them under the plan.

Therefore, it is clear that Section 68, purporting to allow a set-off in bankruptcies generally, is not consistent with those provisions of Section 77 which require equality of treatment for all of each class of creditors. Specifically as applied to this case, it would permit the bank a preference over its fellow First and Refunding bondholders, which is emphatically denounced by Section 77. See subdivisions (c), paragraph 5, (d), (e), (f), and (g), paragraph 1, which provide for the division of all claimants into classes and necessarily require

that all members of each class be accorded like treatment.[2]

Section 68 is likewise inconsistent with subdivision (j) which expressly provides that upon the confirmation of the reorganization plan the property of the debtor shall be free from all claims of every character, except as specified in the plan. Section 68 allowing a set-off is, therefore, utterly inconsistent with subdivision (j), in that it purports to recognize a claim against property which is not recognized by the reorganization plan.

It should be borne in mind that what this case deals with is the right to the present possession of the funds in question. It does not seek to adjudicate the rights of the bank in the property of the debtor as they shall be established and recognized by the reorganization plan. Therefore, the claim advanced by the bank that awarding this fund to the trustees would forever deprive the bank of any superior equities it might have over the other First and Refunding bondholders, and that the *Continental Bank* case is to be distinguished on that ground is without foundation even if the bank is right in its claim that it has any such superior equities. But if such superior equities over the other First and Refunding bondholders do exist (which we emphatically deny), these equities must be determined and made effective, not by the bank itself in its own banking house, or by the District Court of Minnesota in this case, but by the District Court of Illinois which is administering this trust estate, and the Interstate Commerce Commission. These equities cannot be made effective by permitting the bank arbitrarily to withdraw assets from the operation of the plan, but can be recognized only by the

[2] While there is no specific provision that each member of each class must be treated alike, that conclusion necessarily follows from subdivision (c), paragraph 5, requiring the division of creditors into classes, and the subsequent subdivisions referring repeatedly to classes.

"Class.—A group of individuals ranked together * * * as having the same status." (Webster's Dictionary.)

court administering the trust estate by its confirmation of the plan.

Cumberland Glass Company v. *De Witt*, 237 U. S. 447.

It is the court of administration and not the bank which must determine the property on which the plan will operate.

But the bank argues that such construction deprives subdivision (n), so far as it relates to the rights of creditors, of any substantial meaning.

The view of the trial court is indicated by the following excerpt from its memorandum:

> "* * * But we are confronted with the unambiguous language contained in subsection (n) of Section 77 to the effect that the rights and liabilities of creditors with respect to the debtor and his property shall be the same as if a voluntary petition had been filed and the debtor adjudicated a bankrupt. It is fair to assume that, in so far as it may be consonant with the general provisions of Section 77, Congress intended by subsection (n) to fix the status of the parties as to their rights and liabilities with reference to liens, preferences, etc., as would have resulted in the event there had been an adjudication. Obviously, there are many rights of creditors under the Bankruptcy Act that do not arise in a reorganization proceeding, and a recognition of which would be inconsistent with the objects of Section 77, but it must be also recognized that there are many rights of creditors that are necessarily preserved in proceedings under this reorganization act. For instance, the claims of creditors who have received preferences would be governed by the general provisions of the act. Claims entitling to priority would be recognized. The so-called four months rule would apply, and as suggested before, it is difficult to understand any inconsistency between the exercise of the right of

set-off when the reorganization plan is being effected." 11 Fed. Supp. 929, 935.

In this, we submit that the court gave to subdivision (n) a construction far beyond its proper scope. It is clear, we think, that what was intended was no more than that the second purpose above suggested should be accomplished, namely, that the remedies of all creditors should be stayed pending the reorganization.

Subdivision (n) is a "residuary" statute, a catchall. In view of its restrictive application "consistent with the provisions hereof," it could hardly be claimed that subdivision (n) had the effect of reading into Section 77 any provision of the old bankruptcy law covering any phase of the subject covered by Section 77. To illustrate, the old bankruptcy law contains a complete code as to the remedial rights of creditors in such a proceeding, election of trustee, conversion of property into cash, payment of dividends, etc. Obviously, these provisions are inconsistent with Section 77 and do not become a part of it, because in the latter section we find elaborate provisions as to the only remedy a creditor has (whether secured or not and whether occupying a preferential status or not), *i. e.*, to participate in the reorganization plan.

It is, therefore, clear that so far as the remedial rights of creditors in the proceeding are concerned, subdivision (n) is wholly without application. It does not purport to prescribe what a creditor may do in the proceeding for that is fully covered by subdivisions (b), (c), (d), (e), (f), (g), (h), and (j), and those subdivisions provide the only things that he can do. It does not "preserve" any rights because they are all otherwise preserved. But there is no express provision in Section 77 preventing a creditor from levying, attaching, or otherwise impounding a debtor's property after the filing of

the petition. Subdivision (n), therefore, so far as it deals with the rights of creditors, was intended to accomplish just one thing. It was intended, not to prescribe what a creditor could do, but to prescribe what he could not do, *i. e.,* to prevent him from pursuing his usual remedies against the debtor outside the reorganization proceedings.

The trial court, however, by permitting the bank, as the holder of unmatured bonds, to set them off at par against the bank deposits of the railway mistakenly distorted the scheme of Section 77 and the intention of Congress in enacting it. Such a decision allows a creditor, who happens also to be a debtor, and for no other reason, to ignore the reorganization proceeding, jeopardize its progress and consummation, and pay itself off in full to the detriment and disadvantage of other creditors, mortgagees, and lien holders who possess at least equal, if not superior, equities.

The right of set-off, when it exists, though perhaps more than "a procedural convenience" is, at most, a remedial right rather than a substantive right—a mere means of collection. Section 77, in and of itself, prescribes the whole remedy, the only remedial right, which a creditor is entitled to in a proceeding brought under the section, *i. e.,* participation in a reorganization plan and that only.

It is apparent from what has been said that the only purpose which subdivision (n) accomplishes (so far as it deals with the rights of creditors) is that it limits those rights and prevents (as would an ordinary adjudication in bankruptcy) the levying, attaching, or otherwise seizing or impounding the debtor's assets. If subdivision (n) were entirely omitted, every other right of creditors is expressly provided for.

In short, the only purpose of subdivision (n) is to provide that the approval of the petition for reorganization shall during the period of such reorganization also operate as a writ of sequestration and injunction.

A very persuasive case in this connection is a decision under Section 77B, a cognate statute, providing for the reorganization of business corporations. We refer to *Grand Boulevard Investment Co.* v. *Strauss*, 78 Fed. (2d) 180 (Eighth Circuit), which seems absolutely parallel to the case at bar.

In that case, upon default in a real estate mortgage more than four months previous to the filing of a petition under Section 77B, the property was turned over to the possession of the mortgagee, who became therefore a mortgagee in possession. Upon the filing of the petition under Section 77B, the debtor petitioned for an order to be restored to possession. The lower court denied the petition on the ground that it lacked the requisite power. The Eighth Circuit reversed that holding and held that in spite of the fact that the mortgagee had been in possession for more than four months previous to the filing of the reorganization petition and that that court in bankruptcy cases proper had recognized that under such circumstances a mortgagee in possession could be ousted only upon payment of his mortgage, such rule did not apply to a proceeding under Section 77B, and that such mortgagee in possession could be ousted and the property redelivered to the debtor for the purpose of accomplishing a reorganization.

Will the court bear in mind the absolute parallel features of this case and the case at bar?

In the *Grand Boulevard* case, the mortgagee was in possession under a mortgage.

In the case at bar, the bank is in possession under what the trial court terms a "possessory lien," but what

the Eighth Circuit, in the case of *Clearwater County* v. *Pfeffer,* 236 Fed. 183, terms a mere right of set-off, and this court in *Studley* v. *Boylston National Bank, supra,* terms a "banker's lien" or "right to use his claim * * * in satisfaction of what he owes."

In the *Grand Boulevard* case, had the proceeding been an ordinary bankruptcy, the mortgagee could have retained possession and could not have been ousted, but since it was not an ordinary bankruptcy but a reorganization, the right under the old bankruptcy law to retain possession was not preserved, because it could not be preserved if the purposes of Section 77B were to be accomplished.

The same conclusion must be reached in the case at bar, *i. e.,* the so-called "possessory lien" or right of set-off is not preserved under Section 68 in a proceeding under Section 77.

The first question should be answered in the negative.

B.

Question 2. If the first question be answered in the affirmative, can a bank which owns the unmatured bonds of a railroad corporation set off a deposit account of the railroad with the bank against the bonds, upon the filing by the railroad of a petition for reorganization under Section 77 of the Bankruptcy Act, alleging that the railroad is unable to meet its debts as they mature?

That the First and Refunding Bonds were in good standing on June 7, 1933 (they being not yet due and there being no default in interest), is conceded.

In the *Continental Bank* case, this court held (*a*) that the words "bankrupt" and "insolvent" were synonymous, and (*b*) that a railway need not be insolvent to

come under Section 77, that it was enough that it be unable to meet its debts as they mature without any insolvency. The original Bankruptcy Act, Section 1 (U. S. C. Title 11, Chapter 1, Section 1), defines insolvency as follows:

> "(15) A person shall be deemed insolvent within the provisions of this title whenever the aggregate of his property, exclusive of any property which he may have conveyed, transferred, concealed, or removed, or permitted to be concealed or removed, with intent to defraud, hinder or delay his creditors, shall not, at a fair valuation, be sufficient in amount to pay his debts."

Later (19) in the same section, the word "persons" is defined to include corporations. The railway was not insolvent.

Under these circumstances, the familiar rule applies that an unmatured debt cannot be offset except in the event of the insolvency of the debtor. There is no question of what the general rule is. *Schuler* v. *Israel,* 120 U. S. 506. In *Clearwater County* v. *Pfeffer,* 236 Fed. 183, the Eighth Circuit said:

> "The right of a banker, sometimes loosely styled a lien, to charge up to a depositor without his order, his note or other obligation to pay before it is due is conditioned on the latter's insolvency."

(See also annotations in 25 L. R. A. (N. S.), 393, and 43 A. L. R. 1325, 1328.)

The converse is perhaps true, that if the debtor is insolvent the offset of an unmatured claim is permitted, although in most cases, in addition to insolvency, there were other equities which justified the set-off. This is the rule in the Minnesota state courts.

Stolze v. *Bank of Minnesota,* 67 Minn. 172; 69 N. W. 813.

Sweetser v. *Peoples Bank of Minneapolis,* 69 Minn. 196; 71 N. W. 934.

Wunderlich v. *Merchants National Bank,* 109 Minn. 468; 124 N. W. 223.

Platts v. *Metropolitan National Bank,* 130 Minn. 219; 153 N. W. 514.

The trial court seems to hold that, while this is the general rule, the facts here brought the case within an equitable exception. This is what the court said:

> "Therefore, while evidence is lacking that, marshalling assets against liabilities, the railway company is insolvent, there is a strong showing of insolvency that equity should recognize in support of the defendant's set-off irrespective of the bankruptcy statute." 11 Fed. Supp. 929, 936.

We submit that the bank is no such favorite of the law and has no such special equities as to justify the court in relaxing, in the exercise of its equitable jurisdiction, the general rule of set-off.

We are wholly unable to appreciate either the argument of counsel or the holding of the trial court that the equities in this case are in favor of the bank. On the contrary, it seems too clear for comment that they are strongly against the bank and strongly in favor of the trustees. In *Gray* v. *Rollo,* 18 Wall. 629, this court said:

> "Other instances are given by way of illustration of the principle on which a court of equity will deviate from the strict rule of mutuality, allowing a set-off; all of them based on the idea that the justice of the particular case requires it, and that injustice would result from refusing it; but none of them approaching in likeness to the case before the court. *There is no rule of justice or equity which requires that Gray Brothers should be paid in preference to other creditors of the insurance company, out of the specific assets represented by the notes of Gray and Gaylord.*"

There is nothing whatever in either the letter or spirit of Section 77 to warrant a conclusion that an allegation of temporary financial embarrassment would accelerate an unmatured debt and permit creditors, by means of set-off, to dissipate the very estate upon which the reorganization sought by Section 77 must of necessity be constructed. It cannot have been the intention that an attempt by a railway company to rehabilitate itself under Section 77 should accelerate every debt. Such a holding would completely nullify the law.

The cases cited by the trial court do not justify the conclusion reached. 11 Fed. Supp. 929, 936. These cases merely hold that inability to meet debts as they mature is ground for the appointment of a receiver. This is, of course, conceded to be the true equity rule. Section 77 merely extends this rule and makes it applicable to a proceeding under it.

All that the railway has done here is to admit a temporary inability to pay its debts as they mature and ask that there be a reorganization of its capital structure. The trial court seems to hold that this petition of itself does not mature its debts because of lack of actual insolvency, but that the filing of the petition affords evidence of the actual financial condition and that that financial condition, irrespective of the proceeding under Section 77, is what matures the debt here for set-off purposes. Possibly the fact of actual insolvency without any adjudication is sufficient to so mature debts under proper circumstances (*Wunderlich* v. *Merchants National Bank,* 109 Minn. 468; 124 N. W. 223), but we have never heard it suggested that a shortage of ready cash resulted in this. We have found no case so holding, nor has the bank cited any such authority.

The bank, however, asserts that, while the question of solvency may be material in an equity receivership,

it is unimportant here, because this is a bankruptcy proceeding (admittedly in a bankruptcy proper all debts become immediately due) and since under Section 63(a) of the Bankruptcy Act (11 U. S. C. 103) any claim whether due or not may be proved (*Carr* v. *Hamilton*, 129 U. S. 252), it may be used as a set-off under Section 68 regardless of insolvency. This argument is unsound for two reasons:

(1) It overlooks the fact that the basis and reason for permitting an unmatured claim to be used as a set-off in a bankruptcy proper rests upon the theory that the debtor is, in fact, insolvent, otherwise he would not be in bankruptcy. Hence, to say that an unmatured claim may be used as a set-off in a bankruptcy proper is merely to say in another way that an unmatured claim may be used as a set-off in a case of insolvency. But it does not follow that an unmatured claim can be used as a set-off in this "special proceeding," because here there is no insolvency.

This would seem conclusive but for one argument advanced by the bank to the effect that our premise is wrong and that a debtor need not actually be insolvent to take advantage of the old bankruptcy law as a voluntary bankrupt. This suggestion has enough support in the decisions of the lower courts to require notice.

Such a rule seems to have been laid down by several of the lower courts.

In re Montevallo Mining Company, 294 Fed. 171 (5th Circuit).

People's National Bank of Plymouth, Ohio v. *Foltz*, 25 Fed. (2d) 295 (6th Circuit).

In re Ann Arbor Machine Company, 278 Fed. 749 (Eastern District of Michigan).

In re Lachenmaier, 203 Fed. 32 (7th Circuit).

In re The C., R. I. & P. Ry. Co., 72 Fed. (2d) 443.

In re Hargadine McKittrick Dry Goods Company, 239 Fed. 155 (D. C. Missouri).

In re Dressler Producing Corporation, 262 Fed. 257 (2nd Circuit).

1, Remington on Bankruptcy, Fourth Edition, Section 48.

This court has never so held, although *Hanover National Bank* v. *Moyses,* 186 U. S. 181, is sometimes cited as an authority for the proposition. However, when the Moyses case is examined carefully, it is apparent that all this court there determined (and by way of argument only) was that when a debtor alleged in his voluntary petition that he was insolvent, it was not a traversable allegation and no issue of fact could be raised as to its truth. This is the language of the court:

> "The act provides that 'any person who owes debts, except a corporation, shall be entitled to the benefits of this act as a voluntary bankrupt,' [3] (Section 4a), and that 'upon the filing of a voluntary petition the judge shall hear the petition and make the adjudication or dismiss the petition.' Section 18g. With the petition he must file schedules of his property, and 'of his creditors, showing their residences, if known, if unknown, that fact to be stated.' Section 7, subd. 8. The schedules must be verified, and the petition must state that 'petitioner owes debts which he is unable to pay in full,' and 'that he is willing to surrender all his property for the benefit of his creditors, except such as is exempt by law.' This establishes those facts so far as a decree of bankruptcy is concerned, and he has committed an act of bankruptcy in filing the petition. These are not issuable facts, and notice is unnecessary, unless dismissal is sought, when notice is required. Section 59g.

[3] The present Act, Section 4 (11 U. S. C. 22) reads:

"Any person, except a municipal, railroad, insurance, banking corporation, or a building and loan association, shall be entitled, etc."

"As Judge Lowell said: 'He may be, in fact, fraudulent, and able and unwilling to pay his debts; but the law takes him at his word, and makes effectual provision, not only by civil but even by criminal process to effectuate his alleged intent of giving up all his property.' *In re Fowler,* 1 Lowell, 161."

If an involuntary bankrupt admits insolvency in his answer, there is nothing to try. It is merely the application of the familiar rule that what is admitted need not be proved. But a judgment based on an admission is just as binding as a judgment after a bitterly controverted trial. In this sense it is, of course, true that a solvent person may be adjudged a voluntary bankrupt under the old law if he alleges (contrary to the fact) that he is insolvent, just as a solvent person may be adjudged an involuntary bankrupt if he admits in his answer (contrary to the fact) that he is insolvent.

(2) As this court held in the *Continental Bank* case, there is a clear-cut distinction between insolvency or bankruptcy on the one hand, and inability "to meet its debts as they mature" on the other (672).

Section 77 allows a railway to invoke the jurisdiction of the court upon either of two separate grounds—insolvency or inability to meet debts as they mature. These terms, as the court says, are in the alternative. They are not the same thing, and the second obviously means something less than the former. If subdivision (n) should not mean merely that the approval of a petition for reorganization shall operate as a writ of sequestration and injunction, as we maintain, but means that the rights of creditors, "in proceedings under this section and *consistent with the provisions* thereof," shall be the same as if a voluntary petition for adjudication had been filed and a decree of adjudication entered, then the proper construction of subdivision (n) must be this: The provisions of the old bankruptcy law, applicable to

insolvency, will apply when the petition alleges insolvency as the ground of jurisdiction but no provision of the old Bankruptcy Act, which is applicable *only* to insolvency, will apply when the ground of jurisdiction is *not insolvency* but "obviously something less." Subdivision (n) would require and work an inconsistency should it operate to convert one of the alternative grounds of jurisdiction,—inability to pay debts,—into the other—insolvency. Such a construction of subdivision (n) would, therefore, be inconsistent with the plain provisions of subdivision (a).

If subdivision (n) means that the law applicable to an insolvent bankrupt shall apply with equal force to a corporation which "although unable to pay promptly, may be able to pay if time to do so be sufficiently extended" and which is by no means insolvent but merely temporarily financially embarrassed, then the filing of a petition for reorganization *ipso facto* immediately accelerates and matures every indebtedness, including mortgages, bonds, equipment trusts, notes, and every other type of obligation outstanding at the time of the filing of the petition.

It is a matter of common knowledge that certain railway companies undergoing reorganization have, with the permission of the court, paid certain interest on their long term issues with the very purpose of preventing an acceleration of their maturities and a consequent default, so that ultimately it might facilitate the reorganization. Yet, if subdivision (n) is to be construed as the trial court construed it, this accomplished nothing, and these bond issues immediately matured and were in default. It is inconceivable that Congress intended any such result. Section 77, then, instead of being an invitation to reorganize, would be a deterrent. The penalty of an unsuccessful attempt at reorganization would be too severe, because the result would be

to mature debts immediately which otherwise would not have been due for many years. Certainly, Congress did not intend to metamorphose a solvent railway corporation into a hopeless insolvent merely because it attempts to reorganize under Section 77.

It is significant that out of the hundreds of railroad receiverships[4] in this country during the past sixty years[4] there is not one reported case where it has been claimed that upon a railway's passing into the hands of a receiver, the bank had the right to set off unmatured railway bonds against its bank account; yet, if the set-off can be effected here, because of mere inability to meet debts as they mature, it could have been in any equity receivership, because Section 68 adopts the equity rule of set-off. (*Sawyer* v. *Hoag,* 17 Wall. 610; *Cumberland Glass Company* v. *De Witt, supra; Studley* v. *Boylston National Bank, supra.*) . It is impossible that the identical situation which exists here has not existed in equity receiverships hundreds of times. It is, therefore, clear that the bar, at least, has always taken the view that under such circumstances the right of set-off did not exist. This fact has great significance. (*Cf. Grosjean* v. *American Press Company, Inc.,* — U. S. —, 56 Supreme Court 444, filed February 10, 1936.) An affirmative answer to Question 2 would mean that a proceeding under Section 77 would be less conducive to a reorganization than an equity receivership.

The second question should be answered in the negative.

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[4] From 1876 to 1935, inclusive, there were 981 receiverships of steam railroads with a total mileage of 334,700 miles, and with a total capitalization (bonds and stocks) of over $16,000,000,000, Railway Age of January 4, 1936 (annual statistical number), page 47, table IX, "Summary of Railroad Receiverships and Foreclosure Sales, 1876 to 1935."

C.

Question 3. If the first and second questions be answered in the affirmative, may the United States District Court, for the district of Minnesota, in the suit by the trustees of the railroad's estate to recover the amount deducted from the account of the railroad by the bank under the claimed right of set-off, recognize and establish as a proper set-off by the bank one which was not made until after the filing of the petition for reorganization and which has never been ordered, authorized, approved, or consented to by the court in which that petition was filed and approved?

As the court below stated in its certificate certifying certain specific questions "the set-off * * * was not ordered, authorized, approved, or consented to by the court in which the petition for a reorganization was filed." (R. 3.)

Even in an ordinary bankruptcy a set-off under Section 68 is not self-executing, nor capable of execution by the parties, but must be approved and acted upon by the court of administration. This is clear from the use of the words "the account shall be stated" and "a set-off shall not be *allowed* in favor of a debtor."

However, this court in *Cumberland Glass Company* v. *De Witt,* 237 U. S. 447, settled the question. In that case, De Witt sued the Glass Company for maliciously inducing a breach of contract by one of its customers. He recovered a judgment in the state courts.

Among the defenses pleaded by the Glass Company was *res judicata,* and the adjudication relied upon consisted of this: previously De Witt had been adjudged a bankrupt; he had scheduled among his liabilities an indebtedness due to the Glass Company and among his

assets the same claim for which he was bringing suit. Conceding that it might have been done if proper action had been taken, nevertheless, the court administering the bankruptcy had not been asked to and had not set off the liability of the Glass Company to De Witt (scheduled as an asset) against the liability of De Witt to the Glass Company (scheduled as a liability).

Later a composition agreement was approved by a majority of creditors (although the Glass Company did not join in such approval) and made effective by the court. The Glass Company received and accepted its dividends under the composition, and no claim was made that the composition was not binding upon it.

It was urged in this court by the Glass Company that De Witt's claim against it had automatically been offset against its claim against De Witt, and, hence, that the composition operated to extinguish the net balance in favor of the Glass Company, and that the claim of De Witt against the Glass Company was extinguished by offsetting it against the Glass Company's claim against him.

De Witt, however, urged that since the court had not ordered or authorized the offset there had been no offset, and, hence, that while the claim of the Glass Company was extinguished by the composition, the claim of De Witt against the Glass Company was unaffected by it, but was restored to him, unaffected by the bankruptcy proceedings.

In discussing the provisions of Section 68(a) the court said:

> "The object of this provision is to permit, as its terms declare, the statement of the account between the bankrupt and the creditor, with a view to the application of the doctrine of set-off between mutual debts and credits. The provision is permissive rather than mandatory, and does not enlarge the doctrine of set-off, and cannot be invoked in cases

where the general principles of set-off would not justify it. Black, Bankr. 544; *Re Kyte*, 182 Fed. 166. *The matter is placed within the control of the bankruptcy court, which exercises its discretion in these cases upon the general principles of equity. Hitchcock v. Rollo*, 3 Biss. 276, Fed. Cas. No. 6,535. The section was taken almost literally from Sec. 20 of the act of 1867 (14 Stat. at L. 526, chap. 176). In *Sawyer* v. *Hoag*, 17 Wall. 610, 21 L. ed. 731, in considering that section of the act of 1867, this court said: 'This section was not intended to enlarge the doctrine of set-off or to enable a party to make a set-off in cases where the principles of legal or equitable set-off did not previously authorize it.' While the operation of this privilege of set-off has the effect to pay one creditor more than another, it is a provision based upon the generally recognized right of mutual debtors, which has been enacted as part of the bankruptcy act, and when relied upon should be enforced by the court. *New York County Nat. Bank* v. *Massey*, 192 U. S. 138, 48 L. ed. 380, 24 Sup. Ct. Rep. 199.

"It hence appears that the object of this section was to give the district court the right to apply the established principles of set-off to mutual credits, *when its action was invoked for that purpose.*

"The language of the act indicates the necessity of action by the court, for the statute provides that *'the account shall be stated'* and the one debt set off against the other, and the balance only allowed to be paid. This statute recognizes the nature of set-off, as established in common law and equitable procedure.

* * *

"In the present case, the Glass Company made no attempt to invoke the action of the district court in the bankruptcy proceedings. If it had the right to do so, it did not seek the action of the bankruptcy court to state the account or make the settlement, and we have been unable to find any case, and none is called to our attention, in which it is held that

simply because of the bankruptcy proceedings and the filing of the schedule and proofs of debt the set-off is automatically made between parties holding mutual credits. On the other hand, as the section indicates, and so far as we know, all the authorities hold, this section is not self-executing, but its benefit is to be had upon the action of the district court only when it is properly invoked, and that court has the primary duty of determining for itself whether there are 'mutual debts or credits' that should be set off one against the other according to the true intent and meaning of the bankruptcy act.

* * *

"There is lacking in this case the first and most essential element of *res judicata; namely, former* judgment of a competent court, adjudicating the matter in controversy between the parties, yet *res judicata* in the bankruptcy court by the former proceedings was the sole contention of Federal right here put in issue."

It is also important to notice the language of the dissenting opinion written by the Chief Justice, in which three Justices concurred. Although the dissent was as to the conclusion, the language of the dissenting opinion with reference to Section 68(a) and the forum of its application is in accord with the majority opinion, and absolutely controlling here.

"(a) Did the bankrupt law confer upon the Glass Company the right to have the scheduled claim against it for damages when liquidated set off against the debt which it proved for the price of the goods by it sold? That the comprehensive provisions of Secs. 68a and b of the bankrupt law relating to set-offs and counterclaims are coincident with the scope of the act, and therefore give the power *to the bankruptcy court to determine* whether or not the right of set-off exists as between all and any claims required to be surrendered as assets of

the estate, on the one hand, and all debts proved against the estate, on the other, is, I submit, *self-evident; for to hold to the contrary would deprive the bankruptcy court of authority to exert its powers over matters to which its jurisdiction in the nature of things must extend.* It is equally indisputable, as long since settled by this court, that in exerting its powers when occasion requires it as between all or any of the items of the active or passive side of the bankrupt estate, it is the duty of the court of bankruptcy not merely to determine the right of set-off by strict common-law principles, but to govern the subject by the broad doctrines of set-off as administered by courts of equity. *Sawyer* v. *Hoag,* 17 Wall. 610, 21 L. ed. 731. It is also clear that in order to additionally accomplish the public purposes just stated, the bankrupt act in some respects narrows the operation of set-off, since it prevents it from automatically operating by subjecting it in every case to judicial control. Under these principles there is no reason for doubting that the proved claim of the Glass Company against the bankrupt estate was subject under the law to be set off against the scheduled claim held by the estate against the Glass Company whether the latter claim was so liquidated as to enable the set-off to be made, *and that the duty of accomplishing this essential result by the terms of the statute primarily rested upon the bankruptcy court.* I say the terms of the statute, since it in express words commands that the set-off for which it provides shall be accomplished, to the end that a distribution shall be made not upon the original claims, but upon the balances resulting from carrying out the commands of the statute as to set-off."

Following this case, this court in *Isaacs* v. *Hobbs Tie & Timber Company,* 282 U. S. 734, in discussing the question of whether there might be a foreclosure of a real estate mortgage on land in another state without the consent of the bankruptcy court, said:

"Upon adjudication, title to the bankrupt's property vests in the trustee with actual or constructive possession, and is placed in the custody of the bankruptcy court. *Mueller* v. *Nugent,* 184 U. S. 1, 14. The title and right to possession of all property owned and possessed by the bankrupt vests in the trustee as of the date of the filing of the petition in bankruptcy, no matter whether situated within or without the district in which the court sits. *Robertson* v. *Howard,* 229 U. S. 254, 259-260; *Wells* v. *Sharp,* 208 Fed. 393; *Galbraith* v. *Robson-Hilliard Grocery Co.,* 216 Fed. 842. It follows that the bankruptcy court has exclusive jurisdiction to deal with the property of the bankrupt estate. It may order a sale of real estate lying outside the district. *Robertson* v. *Howard, supra; In re Wilka,* 131 Fed. 1004. When this jurisdiction has attached the court's possession cannot be affected by actions brought in other courts. *White* v. *Schloerb,* 178 U. S. 542; *Murphy* v. *Hofman Co.,* 211 U. S. 562; *Dayton* v. *Stanard,* 241 U. S. 588. This is but an application of the well recognized rule that when a court of competent jurisdiction takes possession of property through its officers, this withdraws the property from the jurisdiction of all other courts which, though of concurrent jurisdiction, may not disturb that possession; and that the court originally acquiring jurisdiction is competent to hear and determine all questions respecting title, possession and control of the property. *Murphy* v. *Hofman Co., supra; Wabash R. Co.* v. *Adelbert College,* 208 U. S. 38; *Harkin* v. *Brundage,* 276 U. S. 36. Thus, while valid liens existing at the time of the commencement of a bankruptcy proceeding are preserved, *it is solely within the power of a court of bankruptcy to ascertain their validity and amount and to decree the method of their liquidation. Ex parte City Bank of New Orleans,* 3 How. 292; *Houston* v. *City Bank of New Orleans,* 6 How. 486; *Ray* v. *Norseworthy,* 23 Wall. 128; *In re Wilka, supra; Nisbet* v. *Federal Title & T. Co.,* 229 Fed. 644. The exercise of this function necessarily forbids inter-

ference with it by foreclosure proceedings in other courts, which save for the bankruptcy proceeding would be competent to that end. As mortgaged property ordinarily lies within the district in which the bankruptcy court sits, and the mortgagee can consequently be served with its process, the procedure usually followed is for that court to restrain the institution of foreclosure proceedings in any other. Where the land lies outside the limits of the district in which the bankruptcy court sits, ancillary proceedings may be instituted in the district court of the United States for the district in which the land is, and an injunction against foreclosure issued by the court of ancillary jurisdiction. *In re Patterson Lumber Company,* 228 Fed. 916; 247 Fed. 578. Compare *Security Mortgage Co.* v. *Powers,* 278 U. S. 149. Such injunctions are granted solely for the reason that the court in which foreclosure proceedings are instituted is without jurisdiction, after adjudication of bankruptcy, to deal with the land or liens upon it save by consent of the bankruptcy court."

With what greater strength of reasoning does this rule apply to a proceeding under Section 77? This has already been discussed (pages 15-16). When it is borne in mind that from the instant of the filing of the petition the bankruptcy court has *exclusive jurisdiction* of the debtor and its property *wherever located;* that the bank's debt to the railway company is part of this property; that the sole purpose of the section is a plan of reorganization; that this plan must deal with the rights of creditors, secured and unsecured, including the rights of the bank as a creditor; that the terms and provisions of the plan must be passed upon and approved by the Interstate Commerce Commission and by the bankruptcy court; that subdivision (h) provides that the confirmation of the plan shall discharge the debtor from all debts except as provided in the plan; that subdivision (k) pro-

vides that the property shall go back to the debtor free from all claims except those recognized by the plan; and that the only remedy a creditor can possibly have under Section 77 is in and through that plan,—when all these things are considered, it becomes apparent that the rule in a general bankruptcy proceeding that the set-off can be made only by the action of the bankruptcy court is doubly essential in a proceeding under Section 77.

Otherwise, there could never be a reorganization.

The third question, therefore, should be answered in the negative.

Respectfully submitted,

ALEXANDER E. HORN,
EDWARD S. STRINGER,
DANIEL TAYLOR,
MARCUS L. BELL,
Counsel for Appellants Below.

OTIS F. GLENN,
Of Counsel.

March 14, 1936.

APPENDIX.

AN ACT.

To amend an Act entitled "An Act to establish a uniform system of bankruptcy throughout the United States," approved July 1, 1898, and Acts amendatory thereof and supplementary thereto.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That the Act of July 1, 1898, entitled "An Act to establish a uniform system of bankruptcy throughout the United States," as amended by the Acts of February 5, 1903, June 15, 1906, June 25, 1910, March 2, 1917, January 7, 1922, May 27, 1926, and February 11, 1932, be, and it is hereby, amended by adding thereto a new chapter to read as follows:

"CHAPTER VIII

"PROVISIONS FOR THE RELIEF OF DEBTORS

"SEC. 73. ADDITIONAL JURISDICTION.—In addition to the jurisdiction exercised in voluntary and involuntary proceedings to adjudge persons bankrupt, courts of bankruptcy shall exercise original jurisdiction in proceedings for the relief of debtors, as provided in sections 74, 75 and 77 of this Act.

(Sections 74, 75 and 76 omitted.)

"SEC. 77. REORGANIZATION OF RAILROADS ENGAGED IN INTERSTATE COMMERCE.—(a) Any railroad corporation may file a petition stating that the railroad corporation is insolvent or unable to meet its debts as they mature and that it desires to effect a plan of reorganization. The petition shall be filed with the court in whose territorial jurisdiction the railroad corporation, during the

preceding six months or the greater portion thereof, has had its principal executive or operating office, and a copy of the petition shall at the same time be filed with the Interstate Commerce Commission, hereinafter called the commission: *Provided,* That when any railroad, although engaged in interstate commerce, lies wholly within one State, such proceedings shall be brought in the Federal district court within the state in which the railroad is located. The petition shall be accompanied by payment to the clerk of a filing fee of $100, which shall be in addition to the fees required to be collected by the clerk under other sections of this Act. Upon the filing of such a petition, the judge shall enter an order either approving it as properly filed under this section, if satisfied that such petition complies with this section and has been filed in good faith, or dismissing it if not so satisfied. If the petition is so approved, the court in which such order approving the petition is entered shall, during the pendency of the proceedings under this section and for the purposes thereof, have exclusive jurisdiction of the debtor and its property wherever located. The railroad corporation shall be referred to in the proceedings as a 'debtor.' Any corporation, the majority of the capital stock of which having power to vote for the election of directors is owned, either directly or indirectly through an intervening medium, by any railroad corporation filing a petition as a debtor under this section, or substantially all of whose properties are operated by such a debtor under lease or operating agreement may file, with the court in which such other debtor had filed such a petition, and in the proceeding upon such petition under this section, a petition stating that it is insolvent or unable to meet its debts as they mature and that it desires to effect a plan of reorganization in connection with, or as a part of, the plan of reorganization of such other debtor; and thereupon such court shall

have the same jurisdiction with respect to it, its property and its creditors and stockholders as the court has with respect to such other debtor. Creditors of any railroad corporation having claims or interests aggregating not less than 5 per centum of all the indebtedness of such railroad corporation as shown in the latest annual report which it has filed with the commission at the time when the petition is filed, may, if the railroad corporation has not filed a petition under this section, but subject to first having obtained the approval of the Interstate Commerce Commission, after hearing, upon notice to such railroad corporation, file with the court in which such railroad corporation might file a petition under the provisions of this section, a petition stating that such railroad corporation is insolvent or unable to meet its debts as they mature and that such creditors propose that it shall effect a reorganization; upon such filing of such a petition copies thereof shall be filed with the commission and served by the petitioning creditors forthwith upon the railroad corporation; the railroad corporation shall, within ten days after such service, answer such petition; if such answer shall admit the jurisdiction of the court, that the claims of the petitioning creditors constitute the amounts necessary to entitle them to file such petition under this section, and that the railroad corporation is either insolvent or unable to meet its debts as they mature, the court shall, upon the filing of the recommendations of the commission in writing, enter an order approving the petition as properly filed under this section if satisfied that it complies with this section and has been filed in good faith, or disapprove it if not so satisfied; and if so approved the proceedings thereon shall continue with like effect as if the railroad corporation had itself filed a petition under this section; if such answer shall deny either the jurisdiction of the court or that the claims of the petitioning creditors constitute

such necessary amounts or that the railroad corporation is insolvent or unable to meet its debts as they mature, the court shall summarily try the issues, and if after the filing of the recommendations of the commission in writing it shall find that the petition complies with this section, and has been filed in good faith, the court shall enter an order approving the petition as properly filed under this section, and the proceedings thereon shall continue with like effect as if the railroad corporation had itself filed a petition under this section; otherwise the court shall dismiss the petition.

"(b) A plan of reorganization within the meaning of this section (1) shall include a proposal to modify or alter the rights of creditors generally, or of any class of them, secured or unsecured, either through the issuance of new securities of any character or otherwise; (2) may include, in addition, provisions modifying or altering the rights of stockholders generally, or of any class of them; (3) shall provide adequate means for the execution of the plan, which may, so far as may be consistent with the provisions of sections 1 and 5 of the Interstate Commerce Act as amended, include the transfer or conveyance of all or any part of the property of the debtor to another corporation or to other corporations or the consolidation of the properties of the debtor with those of another railroad corporation, or the merger of the debtor with any other railroad corporation and the issuance of securities of either the debtor or any such corporation or corporations, for cash, or in exchange for existing securities, or in satisfaction of claims or rights, or for other appropriate purposes; and (4) may deal with all or any part of the property of the debtor. The term 'securities' shall include evidences of indebtedness, either secured or unsecured, bonds, stocks, certificates of beneficial interest therein, and certificates of beneficial interest in property. The term

'stockholders' shall include the holders of voting trust certificates. The term 'creditors' shall, except as otherwise specifically provided in this section, include, for all purposes of this section and of the reorganization plan, its acceptance and confirmation, all holders of claims, interests, or securities of whatever character against the debtor or its property, including claim for future rent, whether or not such claims, interests, or securities would otherwise constitute provable claims under this Act.

"(c) Upon approving the petition as properly filed the judge (1) may temporarily appoint from a panel of standing trustees qualified for such service to be selected and designated in advance by the commission a trustee or trustees of the debtor's estate, who shall have all the title and, subject to the control of the judge and consistently with the provisions of this section, shall exercise all the powers of a trustee appointed pursuant to section 44 or any other section of this Act, and, subject to the judge's control and the jurisdiction of the commission as provided by the Interstate Commerce Act as amended, shall have the power to operate the business of the railroad corporation; (2) shall fix the amount of the bond of such trustee or trustees and require the debtor, the trustee, or trustees to give such notice as the order may direct to creditors and stockholders and to cause publication thereof to be made at least once a week for two successive weeks of a hearing to be held within thirty days after such appointment, at which hearing or any adjournment thereof the judge may make permanent such appointment, or may terminate it and may in the manner herein provided for the appointment of trustees, appoint a substitute trustee or substitute trustees, and in the same manner may appoint an additional trustee or additional trustees, and shall fix the amount of the bond of the substitute or additional trus-

tee or trustees; the trustee or trustees and their counsel shall receive such compensation as the judge may allow within a maximum approved by the commission; (3) may for cause shown, and with the approval of the commission, in accordance with section 20 (a) of the Interstate Commerce Act as amended, authorize the trustee or trustees to issue certificates for cash, property, or other consideration approved by the judge, for such lawful purposes and upon such terms and conditions and with such security and such priority in payments over existing obligations, secured or unsecured, as might in an equity receivership be lawful; (4) shall require the debtor, at such time or times as the judge may direct and in lieu of the schedules required by section 7 of this Act, to file such schedules and submit such other information as may be necessary to disclose the conduct of the debtor's affairs and the fairness of any proposed plan; (5) shall determine a reasonable time within which the claims and interests of creditors and stockholders may be filed or evidenced and after which no such claim or interest may participate in any plan except on order for cause shown; the manner in which such claims and interests may be filed or evidenced and allowed, and, for the purposes of the plan and its acceptance, the division of creditors and stockholders into classes according to the nature of their respective claims and interests; (6) shall cause reasonable notice of such determination, or of the dismissal of the proceedings, or the allowance of fees or expenses, to be given creditors and stockholders by publication or otherwise; (7) if a plan of reorganization is not proposed or accepted, or, if proposed and accepted, is not confirmed, within such reasonable time as the judge may, upon cause shown and after considering any recommendation which has been filed by the commission, allow, may dismiss the proceeding; (8) may, within such maximum limits as

are fixed by the commission, as elsewhere provided in subdivision (f) of this section, allow a reasonable compensation for the services rendered and reimbursement for the actual and necessary expenses incurred in connection with the proceeding and plan by officers, parties in interest, reorganization managers, and committees or other representatives of creditors or stockholders, and the attorneys or agents of any of the foregoing, and by such assistants as the commission with the approval of the judge may specially employ; and (9) may on his own motion or at the request of the commission refer any matters for consideration and report, either generally or upon specified issues, to one of several special masters who shall have been previously designated to act as special masters in any proceedings under this section by order of any Circuit Court of Appeals and may allow such master a reasonable compensation for his services. The Circuit Court of Appeals of each circuit shall designate three or more members of the bar as such special masters whom they deem qualified for such services, and shall from time to time revise such designations by changing the persons designated or reducing or adding to their number, as the public interest may require: *Provided, however,* that there shall always be three of such special masters qualified for appointment in each circuit who shall in their respective circuits hear any matter referred to them under this section by a judge of any District Court. For all purposes of this section claims against a railroad corporation which would have been entitled to priority over existing mortgages if a receiver in equity of the property of the debtor had been appointed by a Federal court at the date of the filing of the petition hereunder shall be entitled to such priority, and holders of such claims shall be treated as a separate class of creditors. If in any case in which the issues have not already been tried under the provisions of subdivision (a) of this section any of the debt-

or's creditors shall, prior to the hearing provided for in subdivision (c), clause (2), of this section, appear and controvert the facts alleged in the petition, the judge shall determine, as soon as may be, the issues presented by the pleadings, without the intervention of a jury, and unless the material allegations of the petition are sustained by the proofs shall dismiss the petition. Any creditor or stockholder shall be heard on the question of the permanent appointment of any trustee or trustees, the proposed recommendation, approval, or confirmation of any reorganization plan, and upon filing a petition for leave to intervene on such other questions arising in the proceeding as the judge shall determine. The debtor, or the trustees if appointed, shall within fifteen days or, upon cause shown, such other time as may be directed by the judge, prepare (1) a list of all known bondholders and creditors of, or claimants against, the debtor or its property, and the amounts and character of their debts, claims, and securities, and the last known post-office address or place of business of each creditor or claimant, and (2) a list of the stockholders of the debtor, with the last known post-office address or place of business of each. The contents of such lists shall not constitute admissions by the debtor or the trustees in a proceeding under this section or otherwise. Such lists shall be open to the inspection of any creditor or stockholder of, or claimant against, the debtor, during reasonable business hours, upon application to the debtor or trustees, as the case may be.

"(d) Before creditors and stockholders of the debtor are asked finally to accept any plan of reorganization, the Interstate Commerce Commission shall after due notice hold a public hearing at which the debtor shall present its plan of reorganization and at which, also, such a plan may be presented by the trustee or trustees, or by or on behalf of creditors of the debtor, being not less

than 10 per centum in amount of any class of creditors. Following such hearing, the commission shall render a report in which it shall recommend a plan of reorganization (which may be different from any which has been proposed) that will, in its opinion be equitable, will not discriminate unfairly in favor of any class of creditors or stockholders, will be financially advisable, will meet with the requirements of subdivision (g) of this section, and will be compatible with the public interest. In such report the commission shall state fully the reasons for its conclusions, and it may thereafter, upon petition for good cause shown, and upon further hearing if the commission shall deem necessary, modify any of its recommendations and conclusions in a supplemental report stating the reasons for such modification. Thereafter the plan of reorganization recommended by the commission shall be submitted in such manner as the commission may direct to the creditors and stockholders of the debtor for acceptance or rejection, together with the report or reports of the commission thereon; and the commission may at the same time afford an opportunity to accept or reject any other plan of reorganization filed as in this subdivision (d) provided.

"(e) A plan of reorganization shall not be finally approved by the commission until it has been accepted in writing and such acceptance has been filed in the proceeding by or on behalf of creditors holding two-thirds in amount of the claims of each class whose claims or interests would be affected by the plan, and by or on behalf of stockholders of the debtor holding two-thirds of the stock of each class: *Provided, however,* that if adequate provision is made in the plan for the protection of the interests, claims, and liens of any class of creditors or stockholders in the manner provided in clauses (5) and (6) of subdivision (g), of this section, then the acceptance of the plan by such class of creditors or

stockholders shall not be requisite to the approval of the plan: *And provided further,* that the acceptance of stockholders shall not be requisite to the confirmation of the plan if (1) the judge shall have determined (a) that the corporation is insolvent, or (b) that the interests of stockholders will not be adversely affected by the plan, or (c) that the debtor has pursuant to authorized corporate action accepted the plan, and its stockholders are bound by such acceptance. For the purposes of this section acceptance by a creditor or stockholder shall include acceptance in writing executed by him; or acceptance by his duly authorized attorney or committee acting under authority executed by him subsequent to the recommendation of the plan by the commission. Upon acceptance of the plan in accordance with the provisions of this subdivision (e) the commission may, without further proceedings, grant authority for the issue of any securities, assumption of obligations, transfer of any property, or consolidation or merger of properties, to the extent contemplated by the plan consistent with the purposes of the Interstate Commerce Act as amended. If the United States of America is directly a creditor or stockholder, the Secretary of the Treasury is hereby authorized to accept or reject a plan in respect of the interests or claims of the United States.

"(f) If the plan recommended by the commission is accepted as provided in subdivision (e), the commission shall thereupon certify the plan to the court together with its approval thereof and that the same has been so accepted, together with a report of the proceedings before it and its conclusions thereon. If the plan accepted as provided in subdivision (e) differs from the plan recommended by the commission it shall, upon acceptance, be submitted to the commission, which shall hear all interested parties upon such notice and subject to such rules and regulations as it shall prescribe. If after such

hearing the commission determines that the accepted plan in its opinion is equitable and will not discriminate unfairly in favor of any class of creditors or stockholders; will be financially advisable; will meet the requirements of subdivision (g) of this section; and will be compatible with the public interest; the commission shall thereupon certify the plan to the court, together with its approval thereof and that the same has been duly accepted, and together with a report of the proceedings before it and its findings and conclusions thereon. The commission shall also, after hearing if necessary, fix the maximum compensation and reimbursement which may be allowed by the court pursuant to clause (8) of subdivision (c) of this section: *Provided,* that unless good and sufficient reasons appear therefor no allowance for fees or compensation shall be made to officers of corporations who have acted as managers or in any capacity in connection with the reorganization when such corporation had an interest in the matter. No plan of reorganization shall be confirmed in any proceeding under this section except upon the approval of the Interstate Commerce Commission certified to the court. If the commission shall decline to issue such a certificate it shall file in the proceeding its decision, specifying the particular grounds upon which it bases its disapproval of the plan.

"(g) Upon such approval by the commission, and after hearing such objections as may be made to the approved plan, the judge shall confirm the plan if satisfied that (1) the approved plan complies with the provisions of subdivision (b) of this section, is equitable and does not discriminate unfairly in favor of any class of creditors or stockholders; (2) all amounts to be paid by the debtor or by any corporation or corporations acquiring the debtor's assets, for services or expenses incident to the reorganization and cost of financing, have

been fully disclosed and are reasonable, or are to be subject to the approval of the judge; (3) the offer of the plan and its acceptance are in good faith and have not been made or procured by any means or promises forbidden by this Act; (4) the approved plan provides for the payment of all costs of administration and other allowances made by the court, except that compensation or reimbursement provided for in subdivision (c), clause (8), of this section may be paid in securities provided for in the plan if those entitled thereto will accept such payment and the court finds such compensation reasonable; (5) the approved plan provides, with respect to stockholders of any class the acceptance of which is requisite to the confirmation of the plan, and who would not become bound by the plan under the provision of subdivision (h) of this section, and of which more than one-third have not accepted the plan, adequate protection for the realization by them of the value of their equity, if any, in the property of the debtor dealt with by the plan either by a sale of the property at not less than a fair upset price, or by appraisal and payment in cash either of the value of their stock or, at the objecting stockholder's election, of the value of the securities, if any, alloted to such stock under the plan; (6) the plan provides with respect to any class of creditors the acceptance of which is requisite to the confirmation of the plan, and who would not become bound by the plan under the provisions of subdivision (h) of this section, adequate protection for the realization by them of the value of their securities, liens, and claims, either (a) by the sale of such property subject to their liens, if any, or (b) by the sale free of such liens at not less than a fair upset price, and the transfer of such liens to the proceeds of such sale, or (c) by appraisal and payment in cash of either the value of such liens and claims or, at the objecting creditors' election, the value of the se-

curities allotted to such liens and claims under the plan. Section 57, clause (h), of this Act shall be applicable to the appraisal of securities under this section, and the value of the unpaid balance shall be appraised as an unsecured claim; and (7) the debtor, and every other corporation issuing securities or acquiring property under the plan, is authorized by its charter or by applicable State or Federal laws, upon confirmation of the plan, to carry out the plan. In the case of a sale or appraisal under clause (5) or (6) of this subdivision (g) the court shall refer to the commission for its consideration and determination the amount to be fixed as the upset price and the appraisal of any securities.

"(h) Upon such confirmation the provisions of the plan shall be binding upon (1) the corporation, (2) all stockholders if the judge shall have determined (a) that the corporation is insolvent, or (b) that the interests of stockholders will not be adversely affected by the plan, or (c) that the debtor has pursuant to authorized corporate action accepted the plan and its stockholders are bound by such acceptance, (3) all stockholders of each class of which two-thirds in amount shall have accepted the plan, (4) all creditors whose claims are payable in cash in full under the plan, (5) all creditors entitled to priority under subdivision (c) of this section, whose claims are not payable in cash in full under the plan, provided two-thirds in amount of such creditors shall have accepted the plan in writing filed in the proceeding, (6) all other unsecured creditors, provided two-thirds in amount of such creditors shall have accepted the plan in writing filed in the proceeding, and (7) all secured creditors of each class of which two-thirds in amount shall have accepted the plan. The confirmation of the plan shall discharge the debtor from its debts except as provided in the plan. Upon confirmation of the plan by the judge, the debtor and other corporations

affected by the plan, or organized or to be organized for the purpose of carrying out the plan, shall, subject to the jurisdiction of the Commission, have full power and authority to put into effect and carry out the plan and the orders of the judge relative thereto, the laws of any State or the decision or order of any State authority to the contrary notwithstanding. In the event that the judge should disapprove the plan he shall file an opinion stating his reasons therefor.

"(i) The provisions of sections 721, 722, 723, 724, and 725 of the Revenue Act of 1932 shall not apply to the issuance, transfers, or exchange of securities or filing of conveyances to make effective any plan of reorganization confirmed under the provisions of this section.

"(j) Upon the confirmation of the plan the property dealt with by the plan, when transferred and conveyed to the debtor or other corporation or corporations provided for by the plan, or if no trustee or trustees have been appointed when held by the debtor pursuant to the plan, shall, as the court may direct, be free and clear of all claims of the debtor, its stockholders and creditors, except such as may consistently with the provisions of the plan be reserved in the order confirming the plan or directing such transfer and conveyance, and the court may direct the trustee or trustees, or if there be no trustee or trustees the debtor, to make any such transfer and conveyance, and may direct the debtor to join in any such transfer or conveyance made by the trustee or trustees. Upon the termination of the proceeding a final decree shall be entered discharging the trustee or trustees, if any, making such provisions as may be equitable, and closing the case.

"(k) If a receiver of all or any part of the property of a corporation has been appointed by a Federal or State court, whether before or after this amendatory

Act takes effect, the railroad corporation may nevertheless file a petition or answer under this section at any time thereafter, but if it does so and the petition is approved the trustee or trustees appointed under the provisions of this section shall be entitled forthwith to possession of such property, and the judge shall make such orders as he may deem equitable for the protection of obligations incurred by the receiver and for the payment of such reasonable administrative expenses and allowances in the prior proceeding as may be fixed by the court appointing said receiver within maximum limits approved by the commission. If a receiver has been appointed by a Federal or State court prior to the dismissal under subdivision (c), clause (7), of a proceeding under this section, the judge may include in the order of dismissal appropriate provisions directing the trustee to transfer possession of the debtor's property within the territorial jurisdiction of such court to the receiver so appointed, upon such terms as the judge may deem equitable for the protection of obligations incurred by the trustee and for the payment of administrative expenses and allowances in the proceeding hereunder. For the purposes of this section the words 'Federal court' shall include the district courts of the United States and of the Territories and possessions to which this Act is or may hereafter be applicable, the Supreme Court of the District of Columbia, and the United States Court of Alaska.

"(l) In addition to the provisions of section 11 of this Act for the staying of pending suits against the debtor, such suits shall be further stayed until after final decree the judge may, upon notice and for cause shown, enjoin or stay the commencement or continuance of any judicial proceeding to enforce any lien upon the estate until after final decree.

"(m) A certified copy of an order confirming a plan of reorganization shall be evidence of the jurisdiction of the court, the regularity of the proceedings, and the fact that the order was made. A certified copy of an order directing the transfer and conveyance of the property dealt with by the plan as provided in subdivision (j) of this section shall be evidence of the transfer and conveyance of title accordingly, and if recorded shall impart the same notice that a deed if recorded would impart.

"(n) In proceedings under this section and consistent with the provisions thereof, the jurisdiction and powers of the court, the duties of the debtor and the rights and liabilities of creditors, and of all persons with respect to the debtor and his property, shall be the same as if a voluntary petition for adjudication had been filed and a decree of adjudication had been entered on the day when the debtor's petition was filed.

"(o) No judge or trustee acting under this Act shall change the wages or working conditions of railroad employees; except in the manner prescribed in the Railroad Labor Act, or as set forth in the memorandum of agreement entered into in Chicago, Illinois, on January 31, 1932, between the executives of twenty-one standard labor organizations and the committee of nine authorized to represent Class 1 railroads.

"(p) No judge or trustee acting under this Act shall deny or in any way question the right of employees on the property under his jurisdiction to join the labor organization of their choice, and it shall be unlawful for any judge, trustee or receiver to interfere in any way with the organizations of employees, or to use the funds of the railroad under his jurisdiction, in maintaining so-called company unions, or to influence or coerce employees in an effort to induce them to join or remain members of such company unions.

"(q) No judge, trustee, or receiver acting under this Act shall require any person seeking employment on the property under his jurisdiction to sign any contract or agreement promising to join or to refuse to join a labor organization; and if such contract has been enforced on the property prior to the property coming under the jurisdiction of said judge, trustee, or receiver, then the said judge, trustee, or receiver, as soon as the matter is called to his attention, shall notify the employees by an appropriate order that said contract has been discarded and is no longer binding on them in any way.

"(r) The term 'railroad corporation' as used in this Act means any common carrier by railroad engaged in the transportation of persons or property in interstate commerce, except a street, suburban, or interurban electric railway which is not operated as a part of a general railroad system of transportation or which does not derive more than 50 per centum of its operating revenues from the transportation of freight in standard steam railroad freight equipment.

"(s) In proceedings under this section, claims for personal injuries to employees of a railroad corporation, and claims of personal representatives of deceased employees of a railroad corporation arising under State or Federal laws, shall be preferred claims against the assets of such railroad corporation in receivership or in reorganization as herein provided, such claims to be subordinate only to costs of administration of such receivership or reorganization."

SEC. 2. This Act shall take effect and be in force from and after the date of its approval, and shall apply as fully to debtors, their stockholders and creditors, whose interest or debts, whether secured or unsecured, have been acquired or incurred prior to such date, as to debtors, their stockholders and creditors, whose interest or

debts have been acquired or incurred after such date. Proceedings under section 1 of this Act may be taken in proceedings in bankruptcy which are pending on the effective date of this Act.

SEC. 3. In all bankruptcy proceedings the officers and agents in charge of the bankrupt funds are authorized to deposit the same without limit as to amount in the postal savings depositories at the prescribed interest rate in all cases where local banks are unable or unwilling to give the required security. Such deposit or any portion thereof may be withdrawn as required in the bankruptcy proceedings.

Approved, March 3, 1933.